
Investment Policy & Guidelines Statement

Alabama Prepaid Affordable College Tuition (PACT) Trust Fund

August, 2006

Introduction

Purpose

The Board of Trustees (“Board”) of the Alabama Prepaid Affordable College Tuition (PACT) Trust Fund (“Fund”), on the advice and with concurrence of the Fund’s Staff and Consultant, hereby adopts this Investment Policy Statement (“Statement”) for the Fund and is hereby incorporated into all existing and any future Investment Manager Agreements.

The purpose of this Statement is to foster an effective working relationship with the Fund’s investment managers through a discipline of good communication. The Statement is intended to provide the Board with a foundation from which to understand specific management styles and strategies, so that the Board can effectively evaluate the performance of the investment managers and oversee the management of the Fund in a prudent manner.

This statement of investment policy is not intended to remain static. At least, annually, the Board will review this Statement and, if deemed advisable, recommend changes. Recommendations from investment managers for improving policies, procedures and operations are always welcome.

This document sets forth the following:

1. The general policies, procedures, investment policies and objectives which the Board judges to be appropriate and prudent to implement its strategic planning for the investment of Fund assets; the performance criteria and policy guide for the future measurement and evaluation of the investment managers of Fund assets.
2. The investment policies and objectives and performance criteria for the investment manager(s).
3. A guideline for the Board’s ongoing supervision of the investment of Fund assets to ensure that the Fund’s investments remain invested in accordance with this Statement.
4. Accounting and Reporting Guidelines for the purpose of measuring the performance of all investment managers.
5. Directed Brokerage Policy.
6. Proxy Voting Policy.

General Policies and Procedures

Duties and Responsibilities

Board of Trustees

The Board of Trustees has the responsibility for establishing and maintaining investment policy that guides the investment of the Fund. The Board is responsible for selecting Investment Managers and Consultants to carry out the Board's investment objectives and policies and for monitoring their performance. The Board shall discharge its duties with care, skill, prudence and diligence under circumstances then prevailing, which a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims. The Board shall accomplish these goals, in part, by diversifying the investments of the Fund with the goal of minimizing the risk of large losses, unless under specific circumstances it is clearly not prudent to do so.

Staff

Staff will prepare recommendations for Board action on issues affecting the Fund. Staff will also interact with the Fund's consultants on a day-to-day basis and assist them in reporting back to the full Board on a regular basis.

Consultants

The Board may retain an objective, third-party performance measurement consultant to monitor the performance of the Fund and the individual managers relative to the objectives and benchmarks set forth in this statement. The performance measurement consultant will provide quarterly reports and will meet with the Board and management as needed, to provide analysis and interpretation of performance. The Board will be entitled to rely on such consultant. The Consultants will assist the Board in formulating and administering investment policy, analyzing existing investments, selecting new investment managers and educating the staff and Board on investment issues.

Investment Managers

Assets will be allocated to professional investment managers in accordance with manager structure policy. The individual managers will be judged according to benchmarks that reflect the objectives and characteristics of the strategic role their portfolio is to fulfill.

In recognition of their roles as fiduciaries of the Fund, the investment managers assume the following responsibilities:

Concerning their investment programs investment managers are expected:

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- To invest with the same care, skill, prudence and due diligence under the circumstances then prevailing, that an experienced, professional investment manager acting in a like capacity and fully familiar with such matters, would use in the investment of like assets with like aims.
 - To exercise investment discretion (including holding cash equivalents as an alternative) within the policy objectives and guidelines set forth herein. Such discretion includes decisions to buy, hold or sell securities in amounts and proportions reflective of the manager's current investment strategy and that are compatible with the policy objectives and guidelines.
 - To avoid all conflicts of interest when using Fund assets to pay brokerage expenses and to ensure that all trading expenditures are made for the benefit of the Fund. To monitor trading costs and obtain best execution in view of relevant information at the lowest possible cost to the Fund.
 - To comply with all appropriate objectives and guidelines pertaining to their role, asset class, and vehicle type.

Custodian

The Board may appoint an independent custodian to hold the PACT assets and to ensure their safekeeping. The appointment of an independent custodian is an effective way to safeguard the physical and legal integrity of the assets. The custodian should not be able to absolve itself of its responsibility by entrusting to a third party all or some of the assets in its safekeeping. The Board may also appoint the custodian to provide additional services such as securities lending, cash management, investment accounting and reporting, and performance measurement.

Securities Lending

Securities lending is permitted as an opportunity to earn additional income. The policies and guidelines governing securities lending shall be with the master custodian, unless contracted otherwise.

The objective of securities lending is to earn income through a conservatively operated and well-controlled program. There is no absolute return expectation; rather, income is expected commensurate with the market demand for the securities made available by the Fund and the return earned on the investment of cash collateral. Cash collateral received will be invested in a high-quality investment program that emphasizes the return of principal, maintains required daily liquidity, and ensures diversification across approved investment types. Those objectives are pursued within the parameters governing the program as outlined in the securities lending agreements with agent banks. Each agent bank is required to act as a fiduciary with respect to the Fund, and to have systemic and procedural controls in place to ensure adherence to guidelines for operating the securities lending program on behalf of the Fund. The results of the securities lending program are reported to the Board on a regular basis.

Procedures for Manager Selection

Investment managers employed by the PACT Board will be selected through a thorough search and review process, which will include all or some of the following steps:

- Formulation of specific manager search criteria that establishes the qualifications for the manager's role in the strategic plan.
- Identification of qualified candidates from Board members, staff, State Purchasing and/or the manager search database maintained by the Fund's investment consultant.
- Conduct due diligence on each candidate that will include performance screening, qualitative screening and/or onsite visits.
- Selection and interview of finalist candidates based on final results of the due diligence process.
- Evaluation of any potential conflicts of interest.

In general, the Board will evaluate investment manager candidates using the following qualities/expectations. The absence of any one of these qualities will not necessarily disqualify any candidate nor will the presence of all of these qualities assure selection of any candidate. Final selection is at the discretion of the Board: The characteristics of the Managers(s) are to be:

- A bank, an insurance company, or an investment advisor registered under the Investment Advisers Act of 1940.
 - A stable organization with minimal professional turnover.
 - A company policy and practice of equal employment opportunity and non-discrimination based on race, creed or gender.
 - A philosophy and investment strategy that is clearly articulated and has been consistently applied over time.
 - An investment process including buy and sell disciplines that are explicitly defined and rigorously executed.
 - A track record of at least three years established by the manager or management team that will be responsible for the Fund portfolio with the key people in the organization having at least five years of experience managing assets in a similar style. Ability to provide historical time-weighted quarterly returns gross & net of fees for a composite of similar accounts along with a published fee schedule.
 - Investment performance that consistently exceeded the median of a database of managers with similar style. However, superior recent performance should not be a major selection factor.
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Total Fund

Strategic

Asset Allocation

One role of the Board is to reasonably attempt to maximize the benefits to be gained from the investment process. With this in mind, a strategic asset allocation has been established based on the principle that individual asset classes have different investment characteristics and that asset classes can be combined to optimize the objectives of the Fund. The goal of this strategic asset allocation is a Fund that is efficient, well diversified, and manageable over the long-term. The benefits of this diversification are reduced risk and improved investment returns.

This strategic plan for investing the assets of the Fund has been established with a time horizon of three to five years. This plan will be reviewed by the Board at least every 3 to 5 years to determine if it should be modified given existing and anticipated circumstances in the condition of the Fund and the prospects for the capital markets.

The Board has currently adopted the following strategic asset allocation:

<u>Asset Class</u>	<u>% Allocated</u>	<u>Range</u>
Domestic Large/Mid Cap Stocks	42%	+/-5%
Domestic Small Cap Stocks	9%	+/-3%
International Equity	21%	+/-3%
Domestic Bonds and Cash	28%	+/-5%

* - The overall Fund does not have a strategic allocation to cash but individual managers will hold varying amounts of cash within their respective portfolios as part of the normal course of managing their portion of the Fund. This is specifically addressed within the individual asset class guidelines to follow.

Rebalancing Guidelines

The asset allocation of the Fund will be maintained as close to the target allocation as reasonably possible. Rapid unanticipated market shifts or changes in economic conditions may cause the asset mix to fall outside of the policy range. Cash additions and withdrawals shall be allocated across portfolios to bring the asset mix as close to the target allocation as possible.

If the asset allocation cannot be maintained within the above policy limits through cash additions or withdrawals, assets shall be shifted across investment management portfolios to restore the strategic asset allocation. Such reallocations are anticipated to occur infrequently. The consultant will be responsible for alerting the Board when it is necessary to re-balance the portfolios and across asset classes as necessary to conform to the adopted investment policy.

Manager Diversification

The Board will provide each investment manager with guidelines for the investments entrusted to them. These guidelines may be stricter or more flexible than these Policies as appropriate for the assets to be managed and the strategies to be used. Where the manager guidelines differ from these Policies, the manager shall be bound by the manager guidelines.

Performance Objectives for the Total Fund

The following Total Fund performance objectives address aspects of performance comparison and are important to the overall success of the Fund. Upon applying and/or reviewing them, their relative importance and/or implications should be noted. The primary objective needed to maintain the perpetuity of the Fund is listed as objective number one. Given the unpredictable nature of the economy going forward, objective number two is to at least achieve the passive alternative to the current strategic plan over the long-term and is provided as a minimum goal. This will ensure that the Fund is at least keeping up with the direction of the overall market. In addition, when considering the ongoing volatility of the markets, maintaining a positive relationship to a relevant peer group keeps overall performance in perspective. This is addressed with objectives three and four and should be looked at on an asset allocation adjusted basis.

1. The total return shall exceed the actuarial discount rate over the long term.
2. The total return shall exceed a blended benchmark representing both historical as well as current allocation decisions. It will be comprised of the passive indices for each asset class and sub asset class represented in the asset allocation. The following is the current composition:

*42% Russell 1000 index, 9% Russell 2000 index, 21% MSCI EAFE index, 28%
Lehman Brothers Aggregate Bond index*

3. The Fund's overall annualized total return should perform above the median of a relevant Database.
4. Achieve a positive risk/reward trade-off when compared to other plans in a relevant Database (over a minimum 3-year period).

Investment Guidelines

Domestic Equity Investment Managers

Guidelines

1. Equity holdings shall be restricted to readily marketable securities of corporations that are actively traded on major exchanges including the NASDAQ in the U.S. Equity holdings may include American Depositary Receipts traded on U.S. exchanges. Preferred and convertible preferred stocks may be held. Publicly traded Real Estate Investment Trust (REITs) shares may be held and are considered part of the allocation to stocks.
2. Investments should not be made in equity securities of issuers which do not have an available operating history of at least three years. Five years of operating history is preferred. Operating history may include past performance resulting from mergers, acquisitions, and spin-offs.
3. Equity investments in companies with a market capitalization of less than \$50 million at the time of purchase are prohibited investments. Market Capitalization shall be defined as the number of shares outstanding multiplied by the market price per share.
4. Not more than 5% of the total stock portfolio may be invested in the common stock of any one corporation at the time of purchase and no more than 7% in any one corporation at market. Not more than 5% of the outstanding shares of any one company may be held. No more than the lesser of (3 times the sector weight in the index and 40%) valued at market may be held in any one economic sector.
5. Futures and options may be used as a substitute for equity securities provided that they are 100% collateralized by highly liquid securities and do not represent leveraging of the assets.

Pooled/Mutual Fund Exceptions

In the case of a commingled account or mutual fund, the Fund waives strict adherence to the following investment guidelines. Notwithstanding these guidelines, a pooled/mutual fund's investment objectives, policies and restrictions, as set forth in its current prospectus and statement of additional information (as amended from time to time), shall govern the investment of the Fund's assets.

Exclusions

The following categories of securities should not be considered for investment in the Fund without the Board's written approval within the specified manager guidelines:

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1. Unregistered or restricted stock which is not listed or freely traded on any exchange;
 2. Commodities or commodity contracts;
 3. Options, Warrants, Futures (except as previously noted);
 4. Short sales, warrants or margin transactions, or any leveraged investments;
 5. Swaps, Scores, Primes, IOs, POs;
 6. Natural resource properties such as oil, gas or timber;
 7. All forms of Private Equity including, but not restricted to, venture capital or buyout funds.

Investment Guidelines

International Equity Investment Managers

Guidelines

1. Equity holdings shall be restricted to readily marketable securities of corporations that are domiciled in countries outside the United States or generate most of their revenues outside the United States. The securities shall be actively traded on major exchanges in these countries or in the U.S. Equity holdings may include American Depositary Receipts traded and Global Depositary Receipts. Convertible preferred and non-convertible preferred stocks may be held. Exposure to Emerging Markets securities shall be limited to 10% of the market value of the portfolio.
2. Investments should not be made in equity securities of issuers which do not have an available operating history of at least three years. Five years of operating history is preferred. Operating history may include past performance resulting from mergers, acquisitions, and spin-offs.
3. Equity investments in companies with a market capitalization of less than \$100 million at the time of purchase are prohibited investments. Market Capitalization shall be defined as the number of shares outstanding multiplied by the market price per share.
4. Not more than 5% of the total stock portfolio may be invested in the common stock of any one corporation at the time of purchase and no more than 7% in any one corporation at market. Not more than 5% of the outstanding shares of any one company may be held. No more than the lesser of (2 times the sector weight in the index and 40%) valued at market may be held in any one economic sector as defined by MSCI.
5. Futures and options may be used as a substitute for equity securities provided that they are 100% collateralized by highly liquid securities and do not represent leveraging of the assets. Futures and options may also be used to reduce the effect of currency fluctuations on the returns to the fund.

Pooled/Mutual Fund Exceptions

In the case of a commingled account or mutual fund, the Fund waives strict adherence to the following investment guidelines. Notwithstanding these policies, a pooled/mutual fund's investment objectives, policies and restrictions, as set forth in its current prospectus and statement of additional information (as amended from time to time), shall govern the investment of the Fund's assets.

Investment Guidelines

Domestic Fixed-Income and Cash Investment Manager

General Guidelines Domestic Fixed-Income

Debt shall mean marketable debt securities issued by either (1) the United States Government, or its agencies, (2) corporations, or (3) domestic banks and other financial institutions. Mortgage pass-throughs, collateralized debt obligations and 144A securities are permitted.

1. No more than 5% of the total market value of all debt investments should be invested in the debt obligations of any one issuer, with the exception of securities issued and guaranteed by the United States Government, or its agencies, or collateralized by the U.S. Government which may be held without limitation. Holdings of any individual issue must be 5% or less of the outstanding value of the total issue.
2. With the exception of those situations involving reorganization of fund assets, debt investments should be made only in issues with an outstanding value of at least \$50 million, valued at par, at the time of purchase.
3. Mortgage securities held should exhibit price, volatility, and liquidity similar to components of the Lehman Mortgage Backed Securities Index. These may include collateralized mortgage obligations such as pass-throughs, sequential CMO tranches, or planned amortization classes. Asset backed securities including categories other than mortgages may be held provided they are unleveraged, low risk and their values do not change due to the performance of any other security, index or commodity (i.e., structured notes). In determining the acceptability of a derivative, duration must be easily calculated and where duration cannot be calculated, the investment is not permissible.
4. Futures and options may be used provided that they are 100% collateralized by highly liquid securities and do not represent leveraging of the assets.
5. The average effective duration of the portfolio, reflecting all instruments including CMO and Asset-Backed Securities, must be maintained at plus or minus one year of the Lehman Aggregate Bond Index duration.
6. Turnover in the debt portfolio should not exceed 200% in any rolling 12-month period. For purposes of this restriction, turnover shall be defined as the total dollar value of the greater of purchases or sales, divided by the average market value of the debt portfolio for the 12 month period under review. Fixed income managers shall be excluded from this restriction for the first six months of their retention.

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7. Taxable debt obligations issued by municipalities may be considered as possible investments.
 8. Treasury Inflation Protection Securities (TIPs) are allowable investments.

Core Fixed Income Manager Guidelines

1. All securities at time of purchase shall have a Moody's, Standard & Poor's, or Fitch's quality rating of Baa3, BBB- or BBB-, respectively, at a minimum. (If the security is rated by Moody's, S&P and Fitch, the middle rating of the three agencies will govern. In the event the security is rated by two of the agencies, and the third is non-rated, the lower rating of the two agencies will govern. If only one agency assigns a rating, it will govern.)
2. Debt securities which are downgraded below the minimum level defined above should be sold within a 6-month period of such downgrade.

Core Plus Fixed Income Manager Guidelines

1. Core plus managers are permitted to invest in "below investment grade" quality bonds, non-US dollar denominated bonds, and emerging market debt. However, the total amount invested in these securities in the aggregate shall be limited to 30% of the market value of the portfolio.

Guidelines Cash, Money Market Investments, and Short Term Investments

1. Cash and cash equivalent investments shall mean debt obligations with a maturity of 12 months or less at the time of issue.
2. Cash and cash equivalent investments shall be made only in:
 - a. Money market mutual funds;
 - b. Securities rated A-1 by Moody's, P-1 by Standard & Poor's or better by a recognized credit rating service;
 - c. Bank deposits that are (1) fully insured by the Federal Deposit Insurance Corporation, or (2) covered under the SAFE program;
 - d. Repurchase agreements covered under the Master Repurchase Agreement.

Pooled/Mutual Fund Exceptions

In the case of a commingled account or mutual fund, the Fund waives strict adherence to the following investment guidelines. Notwithstanding these policies, a pooled/mutual fund's investment objectives, policies and restrictions, as set forth in its current prospectus and statement of additional information (as amended from time to time), shall govern the investment of the Fund's assets.

Miscellaneous

Brokerage Direction Policy

All separate account managers should participate in the Fund's Directed Brokerage Program subject to the following instructions:

Brokerage transactions in the normal course of business should be directed on a competitive, best execution basis. In addition, brokerage transactions should not be directed if in doing so, taking all factors into consideration, the Fund will incur a disadvantage with respect to the market price of the security. Managers are free to seek the best execution of transactions through any broker. Managers will be advised as to their targeted percentage.

Voting of Proxies

It is expected that the investment managers will review each proxy ballot and vote them in a manner that preserves and enhances shareholder value. Each investment manager shall keep accurate written records of all proxy votes and, on request, provide a detailed report to the Board documenting all votes.

Reporting Requirements

Investment managers are required to provide quarterly reports to the Investment Adviser. Reports should include the following:

- Certification of market value, including a summary of all discrepancies with the master custodian bank that have been outstanding more than 90 days if and when applicable.
- Performance results.
- Notice of any material changes in organizational structure, ownership, key personnel, strategy, philosophy, etc. of the firm.
- Any material litigation pending against the firm or any of its' members whether criminal, civil, or administrative.

On an annual basis the reports should include the annual filing of Form ADV with the Securities & Exchange Commission.

Investment managers must meet with the Board and/or management as required. The Board expects to receive a written summary that responds to the subjects identified in the agenda at least ten days prior to the meeting. These meetings will also provide the investment managers with the opportunity to explain how their investment strategy/outlook has evolved since previous meetings.

The agenda will include the following:

- Performance for past period: Standard time periods for each report will be last quarter, Fund fiscal year to date, calendar year to date, latest one year, three years, five years, seven years, ten years, and since inception. Returns should be annualized for periods longer than one year and calculated on a time-weighted basis for the total portfolio. All returns should include income and dividends and be footnoted as to whether they are gross or net of fees.
- Rationale for performance results: Discussion of the rationale for performance results, relating them specifically to investment strategy and tactical decisions implemented during the current review period.
- Specific near-term strategy: Discussion of the investment manager's specific strategy for the portfolio over the near-term period, with specific reference to asset mix (including cash position) and expected portfolio characteristics.
- Changes in the Investment Manager's firm: Discussion of any changes in the investment manager's firm including, but not limited to, professional turnover, ownership changes, investment strategy, philosophy.
- Changes in the Fund's requirements: Discussion of the required modifications to the investment program and strategy, if any, including changes necessary to comply with new legislation.
- Portfolio outlook: including both short and long term views.

Standards of Performance

Investment performance of various asset classes of securities will be compared, on a time-weighted basis, with that of unmanaged market indices as well as a sample universe of funds as follows:

Domestic large cap equity performance will be compared with the Russell 1000, the S&P 500 and with a sample universe of equity funds. Large cap value manager(s) will be compared to the Russell 1000 Value Index. Large cap growth manager(s) will be compared to the Russell 1000 Growth Index. Index manager(s) will be compared to the specific index, e.g. Russell 1000, Russell 200 and S&P 500. Small/mid cap managers will be compared to the Russell 2000 Index or other suitable indexes.

Developed country foreign stock performance will be compared with the MSCI Europe, Australasia and Far East (EAFE) Index and with a sample universe of developed country foreign equity funds.

Domestic fixed income performance will be compared with the Lehman Brothers Aggregate as well as with a sample universe of fixed income funds with comparable durations.

Ongoing Monitoring

1. Manager Monitoring

The Board will monitor manager performance quarterly. Each quarter, the Board will look principally at three criteria when evaluating individual managers.

- the manager will be evaluated on whether it met or exceeded the assigned Benchmark for the investment style utilized.
- the manager will be evaluated on how well it stayed within the investment discipline for which it was hired
- the manager will be evaluated on whether it fell within the top half of the database comparison with other managers utilizing the same discipline.

2. Manager Review

A thorough Review and Analysis of a Money Manager will be conducted, should:

- A manager perform in the bottom quartile (75 percentile) of its peer group over an annual period.
- A manager fall within the southeast quadrant of the risk/return scatterplot for 3 and/or 5 year time periods
- A manager have a 5-year risk adjusted return fall below that of the median manager with the appropriate peer group.
- Major organizational changes also warrant immediate review of the manager, including change in professionals, significant account losses, significant growth of new business, change in ownership, or regulatory issues or evidence of wrongdoing.

3. Manager Replacement

Performance which may require the replacement of a manager include:

- Managers that consistently perform below the median (50th percentile) of their peer group over annual periods.
- Managers which perform below the median (50th percentile) of their peer group over a three year period.
- Managers with negative alphas for 3 and/or 5 year time periods.

The performance of the Fund's investment managers will be monitored on an ongoing basis and it is at the Board's discretion to take corrective action by replacing a manager if the Board deems it appropriate at any time.

Delegation of Responsibilities

The following chart displays the involvement of each entity as the decision making process of the Program expressed as a presentation of control is:

	Board	Investment Advisor	Investment Manager	Custodian
Asset Allocation Investment Policy	X	X		
Formation of Investment Policy	X	X		
Manager Guidelines	X	X	X	
Manager Selection	X	X		
Performance Evaluation	X	X		
Compliance with Manager Guidelines		X	X	
Execution of Trades			X	X
Collection of Dividends & Interest			X	X
Cash Sweeps			X	X
Recapture Programs	X	X	X	X
Securities Lending	X			X
Proxy Voting			X	X
Trading Verification			X	X

INVESTMENT MANAGER ACKNOWLEDGEMENT

By execution of this document the undersigned hereby acknowledges receipt of the August 2005 Alabama Prepaid Affordable College Tuition Trust Fund's Investment Guidelines. Manager has studied its provisions and will abide by its terms in the fulfillment of the contractual responsibilities to the PACT.

Firm Name

Signed

Date

Printed Name, Position

Telephone Number